

MONTANA LEGISLATIVE BRANCH

Legislative Fiscal Division

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Director
Amy Carlson

EXHIBIT 3
DATE 3/17/11
HB HJ 2

DATE: March 16, 2011

TO: Senator Jim Peterson, Senate President
Rep. Mike Milburn, House Speaker
Senator Bruce Tutvedt, Chair, Senate Taxation
Rep. Mark Blasdel, Chair, House Taxation Committee
Senator Jeff Essmann, Senate Majority Leader
Rep. Tom McGillvray, House Majority Floor Leader
Senator Carol Williams, Senate Minority Leader
Rep. Jon Sesso, House Minority Leader

FROM: Terry W. Johnson, Principal Fiscal Analyst

RE: General Fund Revenue Update Number 2

PURPOSE OF REPORT

This is the second revenue update report designed to brief the legislature on recent economic trends and the corresponding outlook for FY 2011, 2012, and 2013 general fund and common school trust revenue estimates. This analysis is based on collection data received through the end of February 2011 and includes economic forecasts by IHS Global Insight (IHS) for both the national and state economies. This report is presented in three sections: the first section summarizes the new information that has become available to the LFD since our revenue estimate recommendations to the Revenue and Transportation Interim Committee (RTIC) were prepared in mid-November, 2010; the second section summarizes the results of our analysis and the impact on anticipated general fund revenue collections; and the third section provides a "what to watch for" in the next update of this report expected to be issued in mid-April.

It is critical for the legislature to be apprised of current economic conditions and the potential general fund revenue impacts in order to craft a state budget that is balanced as required by the Montana Constitution. This report shows revised LFD estimates that are recommended to be incorporated into HJ2, the revenue estimating resolution.

THE BOTTOM LINE

This analysis shows that general fund revenue collections have improved as compared to the RTIC revenue estimates approved in November 2010. It should be noted, however, that the following recommendations are below the amounts presented in the mid February report when the LFD recommended that the HJ2 estimates be increased by \$97.0 million for the three year period. The LFD is now recommending the HJ2 estimates be increased by only \$63.5 million which is a decrease of \$33.5 million from the February recommendation. The impacts of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (H.R. 4853) and depressed video gaming tax collections account for a majority of this change.

As shown in Figure 1, the interest and income revenue that is deposited to the guarantee account is recommended to be increased by \$9.3 million for FY 2011. The revenue in this account is used to fund public schools. Under current law, more revenue in the guarantee account reduces the amount of general fund appropriation needed to fund public schools. Higher grazing and agricultural fees and oil and gas bonus payments account for the anticipated increase.

Although year to date revenue collections appear to be strong, there are a number of timing and accounting issues that have contributed to this growth. A more thorough analysis on several of the revenue sources that appeared to be exceeding the HJ2 revenue estimate has been prepared. As discussed later in this report, the only major source of revenue that is showing significant improvement over our November 2010 recommendations is individual income tax. Other sources that are showing some improvement are metalliferous mines tax and oil and natural gas production tax. Corporation income taxes have been adjusted downward for the impacts of H.R. 4853. Video gaming taxes continue to show signs of significant weakness and have been adjusted accordingly. Figure 1 shows the total general fund recommended adjustments to the HJ2 revenue estimates.

Figure 1

Recommended Adjustments to HJ2				
Figures in Millions				
Revenue Category	Revision FY 2011	Revision FY 2012	Revision FY 2013	Biennium 2012-13
Individual Income Tax	23.635	27.545	33.880	61.425
Corporation Income Tax	(5.960)	(8.229)	(0.204)	(8.433)
Oil & Gas Production Tax	3.092	1.192	(2.582)	(1.389)
Metalliferous Mines Tax	2.450	2.600	2.620	5.220
Video Gaming Tax	(6.007)	(6.286)	(7.223)	(13.509)
All Other Categories	<u>2.283</u>	<u>1.016</u>	<u>(0.320)</u>	<u>0.696</u>
Total General Fund	\$19.494	\$17.838	\$26.171	\$44.009
Interest & Income	\$9.300	\$0.000	\$0.000	\$0.000

The analysis also shows the major economic assumptions used to develop the RTIC estimates have not changed materially. What has changed is individual income tax refund assumptions

and the impact this will have on the timing of future tax receipts and the federal implementation of H.R. 4853. An analysis prepared by the Department of Revenue (DOR) shows that the estimated general fund revenue reduction due to H.R. 4853 is expected to be \$20.5 million for FY 2011 through FY 2013.

The LFD recommends the HJ2 general fund revenue estimates be increased by \$19.5 million for FY 2011 and \$44.0 million for the 2013 biennium. The revenue improvement for FY 2011 will increase the beginning general fund balance for the 2013 biennium. Because the 2013 biennium revenue improvement is expected to be on-going, the \$44.0 million could be incorporated into the 2013 biennium budget plan on an on-going basis. The next section of the report summarizes the results of our analysis.

NEW INFORMATION

Each month, the LFD receives a revised national economic outlook from IHS. This is the economic forecasting company that Montana has a contract with to provide national and regional economic forecasting services. This service includes written material as well as a variety of economic forecasts for hundreds of economic variables. The information received from IHS in early March reflects their forecasts as of February 2011 for the state and national economies.

The statewide budgeting and accounting system (SABHRS) produces a snapshot of accounting transactions on the last day of each month. The LFD has internal computer processes to download this data and produce a variety of reports and spreadsheets. While this data is critical in monitoring year to date collection trends, this system does not contain any tax return or economic information such as individual and corporate income components, oil and gas production, or prevailing interest rates. This type of detailed data must be extracted from other sources provided the information is available. The accounting transaction detail that is available to the LFD reflects revenue collections through February 2011. Historical collection data by month are available back to FY 2000.

The LFD, in cooperation with the DOR, developed a process whereby the DOR sends the LFD tax return data for fifty different tax types at the beginning of each month. This data is extremely helpful in analyzing various trends that may be occurring within a given tax type. For example, the DOR data show oil production by calendar quarter as reported by the taxpayer. These data are invaluable in tracking production trends throughout the year. It should be noted, however, that since oil production taxes are payable sixty days after the end of each quarter, there is a considerable lag time before the LFD can analyze the data. Nonetheless, these new data were received March 1 and included return information captured in the DOR system as of February 28, 2011.

During each month, there are numerous articles and economic reports that are produced by newspapers, economic websites, and federal entities. To the extent possible, this information is reviewed for relevancy to Montana's economy and the impact it may have on state revenues. Usually this information is for reference and does not have a quantifiable impact on our revenue outlook. This type of information is received and reviewed daily throughout the month.

Based on this new information, the following section of the report highlights our analysis of the new data and summarizes the total LFD recommended changes to the general fund revenue estimates for FY 2011, 2012, and 2013.

RESULTS OF LFD ANALYSIS

The primary components of total general fund revenues are individual and corporate income taxes, property taxes, motor vehicle fees/taxes, and natural resource taxes. If all of these components are added together, over 78 percent of total general fund revenues are produced from these sources. The analysis discussed in this report focuses on the larger revenue sources but also includes information relevant to some of the smaller revenue sources.

This general fund revenue update report focuses on key economic assumptions and the potential impacts on general fund revenue estimates for FY 2011, 2012, and 2013. This report is prepared in a format that compares collection data through February 2011 with collections through February 2010. This type of comparison can provide insight to the strengths or weaknesses of year to date collections and can help identify trends that may be indicative of collections for the remainder of FY 2011. This information can then be used to research the economic conditions that have changed to impact the collection patterns. Economic conditions determine revenue trends - collections do not produce economic activity.

ANALYSIS OF ECONOMIC CONDITIONS

In general, most economic conditions showed minimal change or a slight improvement from the November 2010 IHS forecasts. The following tables show the change in the economic assumptions as prepared by IHS for both the national and state economies. As shown in Figure 2 and 2a, inflation and short-term interest rates have remained virtually unchanged. Oil and natural gas prices have changed – oil prices are up and natural gas prices are down. The S&P index has improved while national corporate profits have slowed. The changes shown are in relation to the IHS November 2010 forecasts.

Figure 2

National Economic Indicators (IHS) March-to-November Comparison												
	Gross Domestic Product			Consumer Price Index			Short-term Interest Rate			Long-term Interest Rate		
	Nov	Mar	Change	Nov	Mar	Change	Nov	Mar	Change	Nov	Mar	Change
2009	14,119	14,119	0	2.145	2.145	0.000	0.567	0.567	0.000	5.037	5.037	0.000
2010	14,630	14,658	28	2.180	2.181	0.000	0.312	0.309	-0.003	4.657	4.695	0.037
2011	15,164	15,348	184	2.215	2.235	0.020	0.432	0.433	0.001	4.204	4.986	0.782
2012	15,836	16,028	192	2.256	2.275	0.019	1.839	1.895	0.056	4.770	5.320	0.549
2013	16,516	16,767	250	2.301	2.320	0.020	3.950	3.970	0.020	6.094	6.110	0.016
	West Texas Oil Price			Henry Hub Nat. Gas Price			S&P 500 Index			Corporate Profits (\$ billion)		
	Nov	Mar	% Chg.	Nov	Mar	% Chg.	Nov	Mar	% Chg.	Nov	Mar	% Chg.
2009	61.767	61.767	0.00%	3.917	3.919	0.06%	947	947	0.00%	1,317	1,317	0.00%
2010	77.452	79.450	2.58%	4.465	4.379	-1.91%	1,117	1,139	2.02%	1,770	1,795	1.39%
2011	82.583	93.071	12.70%	4.181	4.135	-1.10%	1,166	1,334	14.37%	1,824	1,664	-8.77%
2012	89.163	95.164	6.73%	5.238	4.449	-15.05%	1,261	1,407	11.60%	1,883	1,668	-11.43%
2013	93.015	99.015	6.45%	5.573	4.989	-10.48%	1,342	1,487	10.81%	1,861	2,015	8.26%

Figure 2a

National Economic Indicators (IHS) Year-to-Year Growth Comparison																
	Gross Domestic Product				Consumer Price Index				Short-term Interest Rate				Long-term Interest Rate			
	Nov	Growth	Mar	Growth	Nov	Growth	Mar	Growth	Nov	Growth	Mar	Growth	Nov	Growth	Mar	Growth
2009	14,119		14,119		2.145		2.145		0.567		0.567		5.037		5.037	
2010	14,630	3.6%	14,658	3.8%	2.180	1.6%	2.181	1.6%	0.312	-45.0%	0.309	-45.5%	4.657	-7.5%	4.695	-6.8%
2011	15,164	3.6%	15,348	4.7%	2.215	1.6%	2.235	2.5%	0.432	38.5%	0.433	40.1%	4.204	-9.7%	4.986	6.2%
2012	15,836	4.4%	16,028	4.4%	2.256	1.9%	2.275	1.8%	1.839	325.9%	1.895	337.7%	4.770	13.5%	5.320	6.7%
2013	16,516	4.3%	16,767	4.6%	2.301	2.0%	2.320	2.0%	3.950	114.7%	3.970	109.5%	6.094	27.8%	6.110	14.9%
	West Texas Oil Price				Henry Hub Natural Gas Price				S&P 500 Index				Corporate Profits (\$ billion)			
	Nov	Growth	Mar	Growth	Nov	Growth	Mar	Growth	Nov	Growth	Mar	Growth	Nov	Growth	Mar	Growth
2009	61.767		61.767		3.917		3.919		947		947		1,317		1,317	
2010	77.452	25.4%	79.450	28.6%	4.465	14.0%	4.379	11.7%	1,117	18.0%	1,139	20.3%	1,770	34.5%	1,795	36.3%
2011	82.583	6.6%	93.071	17.1%	4.181	-6.3%	4.135	-5.6%	1,166	4.5%	1,334	17.1%	1,824	3.0%	1,664	-7.3%
2012	89.163	8.0%	95.164	2.2%	5.238	25.3%	4.449	7.6%	1,261	8.1%	1,407	5.5%	1,883	3.3%	1,668	0.2%
2013	93.015	4.3%	99.015	4.0%	5.573	6.4%	4.989	12.1%	1,342	6.4%	1,487	5.7%	1,861	-1.2%	2,015	20.8%

Figures 3 and 3a show the forecasts specific to Montana. Wage disbursements and nonfarm employment have remained nearly unchanged, while gross state product and retail sales have shown some improvement. Conversely, housing starts and median house prices show further weakness. The changes shown are in relation to the IHS November 2010 forecast.

Figure 3

Montana Economic Indicators (IHS) March-to-November Comparison									
	Gross State Product* (\$ million)			Wage Disbursements (\$ million)			Non Farm Employment		
	Nov	Mar	% Chg.	Nov	Mar	% Chg.	Nov	Mar	% Chg.
2009	35,102	35,607	1.44%	15,327	15,327	0.00%	429,200	429,967	0.18%
2010	36,349	37,005	1.80%	15,689	15,679	-0.06%	425,777	428,308	0.59%
2011	37,725	38,609	2.34%	16,263	16,310	0.28%	428,022	431,538	0.82%
2012	39,331	40,262	2.37%	16,986	17,134	0.87%	435,747	438,882	0.72%
2013	40,936	42,050	2.72%	17,698	17,939	1.36%	442,766	447,013	0.96%
	Retail Sales (\$ million)			Housing Starts			Median House Price		
	Nov	Mar	% Chg.	Nov	Feb	% Chg.	Nov	Feb	% Chg.
2009	13,902	13,893	-0.06%	1,321	1,321	0.04%	168,660	169,141	0.29%
2010	14,721	14,884	1.11%	1,307	1,230	-5.95%	165,709	165,395	-0.19%
2011	15,432	16,065	4.11%	1,244	1,101	-11.48%	165,332	163,447	-1.14%
2012	16,210	16,851	3.96%	1,716	1,526	-11.04%	172,336	169,829	-1.45%
2013	16,675	17,531	5.13%	1,984	2,042	2.93%	181,008	178,005	-1.66%

Figure 3a

Montana Economic Indicators (IHS) Year-to-Year Growth Comparison												
	Gross State Product* (\$ million)				Wage Disbursements (\$ million)				Non Farm Employment			
	Nov	Growth	Mar	Growth	Nov	Growth	Mar	Growth	Nov	Growth	Mar	Growth
2009	35,102		35,607		15,327		15,327		429,200		429,967	
2010	36,349	3.6%	37,005	3.9%	15,689	2.4%	15,679	2.3%	425,777	-0.8%	428,308	-0.4%
2011	37,725	3.8%	38,609	4.3%	16,263	3.7%	16,310	4.0%	428,022	0.5%	431,538	0.8%
2012	39,331	4.3%	40,262	4.3%	16,986	4.4%	17,134	5.1%	435,747	1.8%	438,882	1.7%
2013	40,936	4.1%	42,050	4.4%	17,698	4.2%	17,939	4.7%	442,766	1.6%	447,013	1.9%
	Retail Sales (\$ million)				Housing Starts				Median House Price			
	Nov	Growth	Mar	Growth	Nov	Growth	Mar	Growth	Nov	Growth	Mar	Growth
2009	13,902		13,893		1,321		1,321		168,660		169,141	
2010	14,721	5.9%	14,884	7.1%	1,307	-1.0%	1,230	-6.9%	165,709	-1.7%	165,395	-2.2%
2011	15,432	4.8%	16,065	7.9%	1,244	-4.9%	1,101	-10.5%	165,332	-0.2%	163,447	-1.2%
2012	16,210	5.0%	16,851	4.9%	1,716	38.0%	1,526	38.6%	172,336	4.2%	169,829	3.9%
2013	16,675	2.9%	17,531	4.0%	1,984	15.6%	2,042	33.8%	181,008	5.0%	178,005	4.8%

*Following the release of the IHS forecast in November, the Bureau of Economic Analysis (BEA) released a comprehensive revision of their GSP figures from 1963 to 2008. The changes included significant classification changes to better reflect state economies.

YEAR TO DATE COLLECTIONS

As discussed in the previous section, there have been some minor changes to the November forecasts of the key economic assumptions at both the national and state levels. Since economic conditions drive revenue receipts there should be a consistency with year to date collection patterns. If a consistency does not exist, then an analysis between economic conditions and actual collections should be prepared to determine what may be causing the variation. This section of the report discusses our analysis of year to date collection trends.

Figure 4 shows general fund revenue collections by individual revenue source. This table is produced monthly based on the revenue transactions recorded on SABHRS. The information shown in Figure 4 represents revenue collections for the first eight months of FY 2010 compared to the first eight months of FY 2011. As shown at the bottom of Figure 4, total general fund collections are \$87.3 million (9.0 percent) above last year. The HJ2 total general fund revenue estimate as adopted by RTIC on November 19th, 2010, expected revenues to be 2.8 percent above FY 2010 collections.

This information seems to indicate that overall, general fund revenue collections are on pace to exceed the HJ2 estimate. However, other than individual income tax, several accounting and timing issues change this perspective. Some of the more significant issues are highlighted in the next section of the report.

Figure 4


<div> <div>Legislative Fiscal Division</div>  </div>							
General Fund Revenue Monitoring Report							
Revenue Source	Actual Fiscal 2010	HJ2 Estimate Fiscal 2011	Through 2/28/10	Through 2/28/11	Difference	% Change	HJ2 Estimate % Change
GF0100 Drivers License Fee	4,156,003	3,561,000	2,463,873.60	2,529,495.38	65,621.78	2.66%	-14.32%
GF0200 Insurance Tax	54,892,354	54,587,000	24,160,693.67	24,448,492.40	287,798.73	1.19%	-0.56%
GF0300 Investment Licenses	6,224,662	6,008,000	5,354,046.69	6,011,438.50	657,391.81	12.28%	-3.48%
GF0400 Vehicle License Fee	89,484,621	92,210,000	46,656,439.67	51,006,554.05	4,350,114.38	9.32%	3.05%
GF0500 Vehicle Registration Fee	14,376,928	14,815,000	7,018,581.68	8,231,684.88	1,213,103.20	17.28%	3.05%
GF0600 Nursing Facilities Fee	5,300,229	5,039,000	2,657,196.16	2,614,143.61	(43,052.55)	-1.62%	-4.93%
GF0700 Beer Tax	3,031,854	3,142,000	1,819,738.76	1,753,992.43	(65,746.33)	-3.61%	3.63%
GF0800 Cigarette Tax	32,217,914	31,029,000	20,500,357.86	19,720,444.20	(779,913.66)	-3.80%	-3.69%
GF0900 Coal Severance Tax	10,321,853	14,848,000	6,078,100.86	6,675,298.13	597,197.27	9.83%	43.85%
GF1000 Corporation Tax	87,900,911	103,320,000	32,004,257.44	54,187,985.04	22,183,727.60	69.31%	17.54%
GF1100 Electrical Energy Tax	4,713,429	4,452,000	2,107,117.39	2,507,358.72	400,241.33	18.99%	-5.55%
GF1150 Wholesale Energy Trans Tax	3,556,056	3,657,000	1,784,837.41	2,024,000.13	239,162.72	13.40%	2.84%
GF1200 Railroad Car Tax	2,579,263	2,031,000	1,977,026.66	1,674,825.79	(302,200.87)	-15.29%	-21.26%
GF1300 Individual Income Tax	717,834,371	738,761,000	541,209,994.37	587,833,307.14	46,623,312.77	8.61%	2.92%
GF1400 Inheritance Tax	90,544	5,000	63,079.77	38,945.62	(24,134.15)	-38.26%	-94.48%
GF1500 Metal Mines Tax	6,541,391	6,481,000	7,225.90	5,748.15	(1,477.75)	-20.45%	-0.92%
GF1700 Oil Severance Tax	95,490,812	101,421,000	21,314,801.54	23,061,185.87	1,746,384.33	8.19%	6.21%
GF1800 Public Contractor's Tax	6,969,395	6,477,000	5,594,563.81	6,332,250.92	737,687.11	13.19%	-7.07%
GF1850 Rental Car Sales Tax	2,807,415	2,999,000	1,701,338.78	1,872,037.22	170,698.44	10.03%	6.82%
GFxxxx Property Tax	222,509,767	229,084,000	128,327,469.60	131,871,727.28	3,544,257.68	2.76%	2.95%
GF2150 Lodging Facilities Sales Tax	12,330,846	12,852,000	7,085,543.58	8,065,360.50	979,816.92	13.83%	4.23%
GF2200 Telephone Tax	-	-	-	-	-	-	-
GF2250 Retail Telecom Excise Tax	23,523,474	21,772,000	6,033,998.79	7,979,075.45	1,945,076.66	32.24%	-7.45%
GF2300 Tobacco Tax	5,334,499	5,680,000	3,184,618.44	3,227,949.13	43,330.69	1.36%	6.48%
GF2400 Video Gaming Tax	52,395,999	55,340,000	27,520,271.56	24,556,591.98	(2,963,679.58)	-10.77%	5.62%
GF2500 Wine Tax	1,932,669	2,098,000	1,172,996.21	1,177,417.97	4,421.76	0.38%	8.55%
GF2600 Institution Reimbursements	22,000,354	17,555,000	10,497,749.52	10,129,061.75	(368,687.77)	-3.51%	-20.21%
GF2650 Highway Patrol Fines	4,646,462	4,666,000	2,530,605.81	2,516,676.70	(13,929.11)	-0.55%	0.42%
GF2700 TCA Interest Earnings	2,692,285	1,666,000	1,722,960.50	1,533,953.70	(189,006.80)	-10.97%	-38.12%
GF2900 Liquor Excise Tax	15,626,091	16,104,000	6,367,910.89	9,411,660.09	3,043,749.20	47.80%	3.06%
GF3000 Liquor Profits	9,000,000	9,511,000	-	-	-	-	5.68%
GF3100 Coal Trust Interest Earnings	26,914,102	26,512,000	13,615,352.89	13,640,375.55	25,022.66	0.18%	-1.49%
GF3300 Lottery Profits	10,631,304	12,327,000	2,794,584.00	2,251,281.00	(543,303.00)	-19.44%	15.95%
GF3450 Tobacco Settlement	3,468,623	3,565,000	-	-	-	-	2.78%
GF3500 U.S. Mineral Leasing	30,287,794	29,674,000	15,257,165.88	16,392,643.77	1,135,477.89	7.44%	-2.03%
GF3600 All Other Revenue	35,360,264	28,883,000	15,878,008.58	18,452,046.77	2,574,038.19	16.21%	-18.32%
Grand Total	1,627,144,538	1,672,132,000	966,462,508.27	1,053,735,009.82	87,272,501.55	9.03%	2.76%

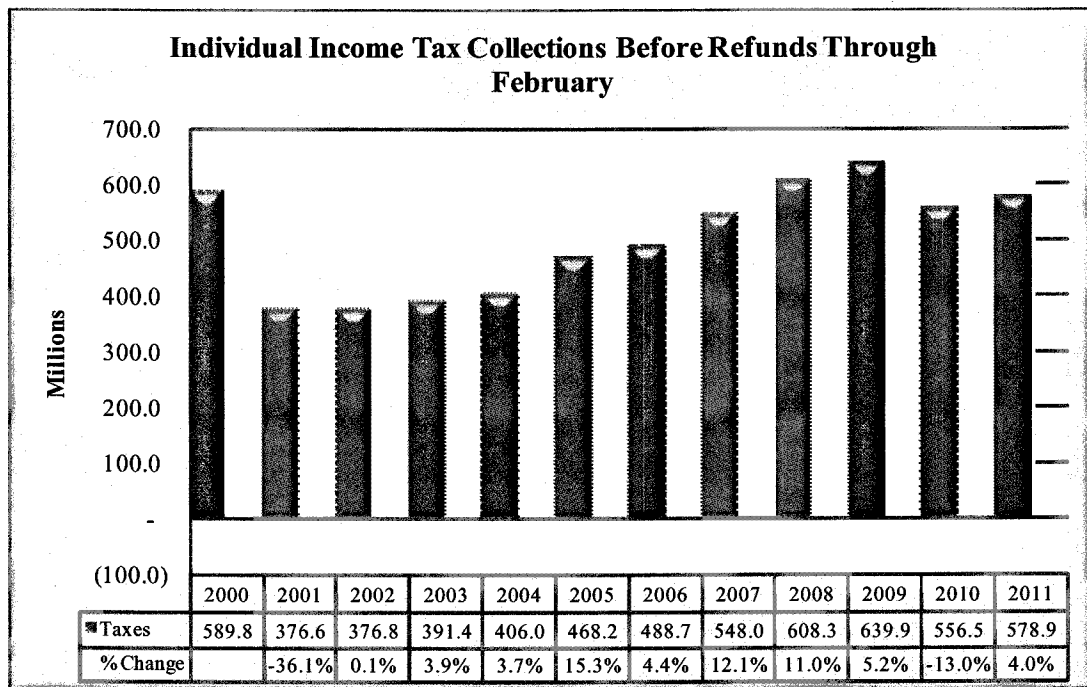
Figure 5 shows a summarization of the data from Figure 1 by two groupings. The Group 1 shows the larger general fund revenue sources. These are the revenue components that are primarily responsible for the increase in year to date collections and/or warranted a significant adjustment of the HJ2 recommendations. Group 2 shows those revenue categories that are showing variations from trends when compared to FY 2010 amounts. Both of these groupings are discussed in the following section.

Figure 5

Summary of Revenue Categories With Significant Collection Variations Fiscal 2010 versus Fiscal 2011 Through February							
Revenue Category	Actual FY 2010	HJ2 Estimate FY 2011	Thru Feb. FY 2010	Thru Feb. FY 2011	Dollar Change	% Change	HJ2 % Change
Group 1							
Individual Income Tax	717,834,371	738,761,000	541,209,994	587,833,307	46,623,313	8.61%	2.92%
Corporation Tax	87,900,911	103,320,000	32,004,257	54,187,985	22,183,728	69.31%	17.54%
Oil & Gas Production Tax	95,490,812	101,421,000	21,314,802	23,061,186	1,746,384	8.19%	6.21%
Video Gaming Tax	52,395,999	55,340,000	27,520,272	24,556,592	(2,963,680)	-10.77%	5.62%
Metalliferous Mines Tax	6,541,391	6,481,000	7,226	5,748	(1,478)	-20.45%	-0.92%
Total	960,163,484	1,005,323,000	622,056,551	689,644,818	\$67,588,267	10.87%	4.70%
Group 2							
Vehicle Fees/Taxes	103,861,549	107,025,000	53,675,021	59,238,239	5,563,218	10.36%	3.05%
Property Tax	222,509,767	229,084,000	128,327,470	131,871,727	3,544,258	2.76%	2.95%
Liquor Excise Tax	15,626,091	16,104,000	6,367,911	9,411,660	3,043,749	47.80%	3.06%
Lodging Facilities Sales Tax	12,330,846	12,852,000	7,085,544	8,065,361	979,817	13.83%	4.23%
Retail Telecommunications Tax	23,523,474	21,772,000	6,033,999	7,979,075	1,945,077	32.24%	-7.45%
Electrical Energy Tax	4,713,429	4,452,000	2,107,117	2,507,359	400,241	18.99%	-5.55%
Other Revenue	35,360,264	28,883,000	15,878,009	18,452,047	2,574,038	16.21%	-18.32%
All Other Categories	249,055,634	246,637,000	124,930,887	126,564,724	1,633,837	1.31%	-0.97%
Total	\$666,981,054	\$666,809,000	\$344,405,957	\$364,090,192	\$19,684,234	5.72%	-0.03%
Grand Total	\$1,627,144,538	\$1,672,132,000	\$966,462,508	\$1,053,735,010	\$87,272,502	9.03%	2.76%

Individual Income Tax (Group 1)

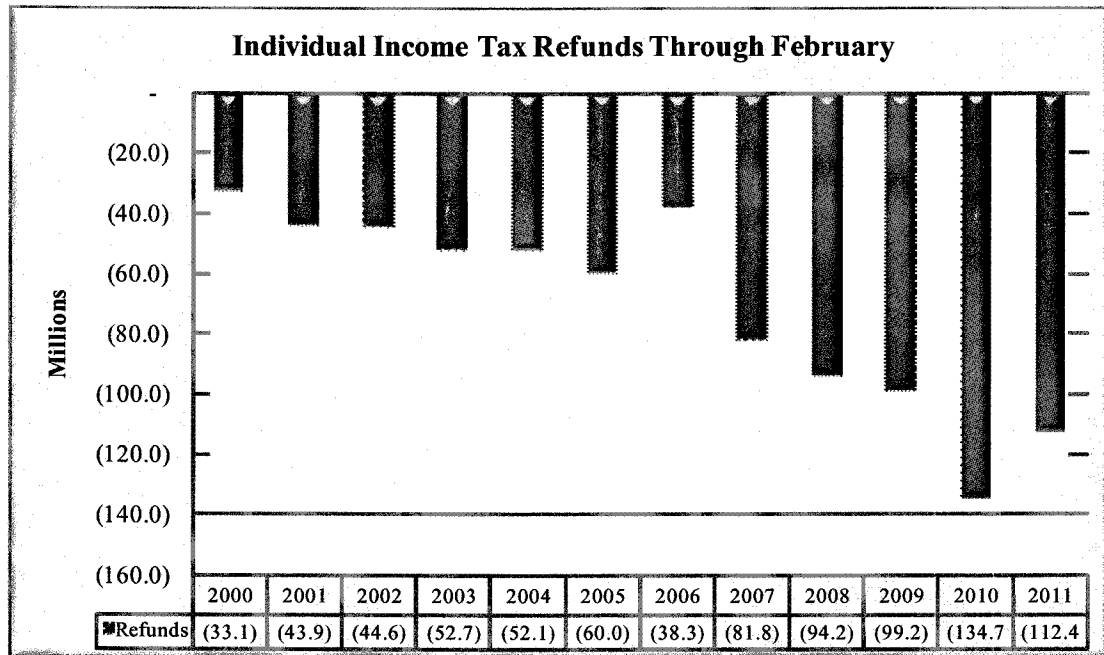
Figure 6 shows individual income tax collection data (less refunds) for the first eight months of FY 2011 compared to the same period of FY 2010. Other fiscal years are shown for reference. As shown in the figure, total individual income tax collections less refunds are 4.0 percent (\$22.4 million) above last year.

Figure 6

The increase suggests that individual income tax collections less refunds are improving and that economic conditions must be recovering from the “Great Recession”. This is good news and is consistent with the economic assumptions approved by the RTIC in November 2010.

As shown in Figure 5, individual income tax collections are up 8.6 percent over last year at this time. If economic growth is doing as expected, then what is causing total individual income tax collections to be growing even faster than expected in HJ2? Figure 7 shows refund activity through February of each year since 2000.

Figure 7



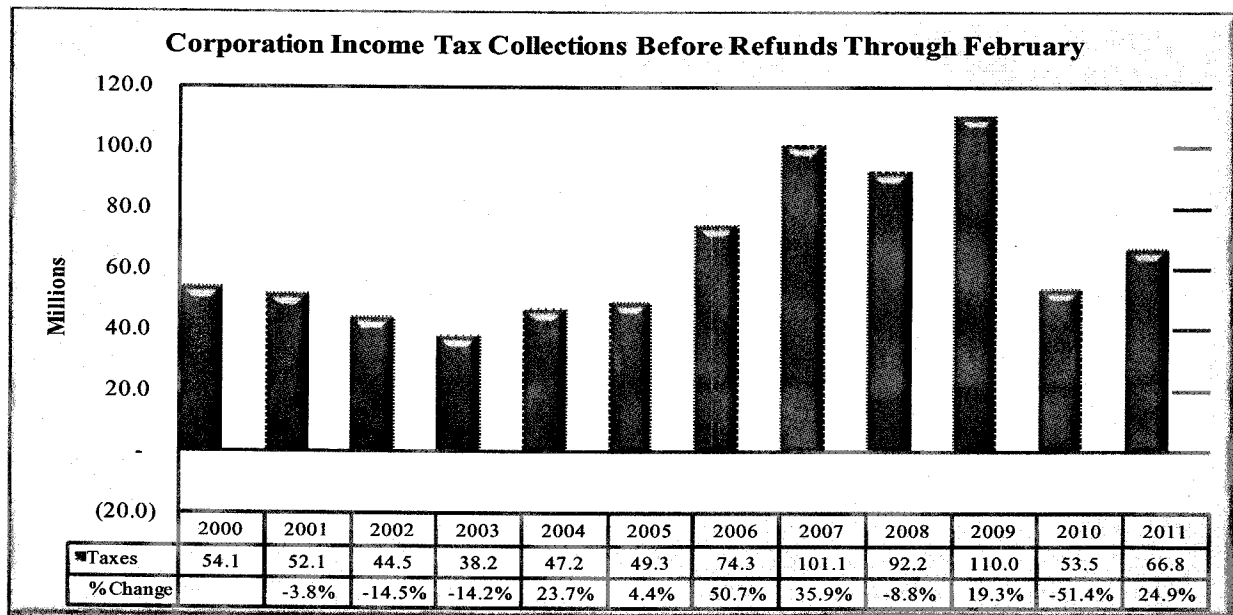
As the figure shows, refunds issued through February of FY 2010 were considerably higher than through February of FY 2011. Revenue estimate recommendations approved by RTIC in November 2010 assumed a higher level of refund activity would continue for all of FY 2011. Since RTIC did not have the benefit of knowing what refunds would be issued in November and December, our analysis suggests there were unusually high refunds in FY 2010 that will not continue into FY 2011. Our revised recommendations are based on refunds returning to a more normal pattern and that the spike observed in FY 2010 will not reoccur. This refund adjustment is the primary reason for the higher individual income tax estimates. The original income growth assumptions approved by RTIC in November have not changed significantly.

H.R. 4853 allows individual income taxpayers to expense depreciable assets placed in service between September 9, 2010 and the end of 2011 and also allows a 50% bonus depreciation for depreciable assets placed in service in 2012. As estimated by the DOR, the expected revenue reduction from this federal legislation is \$4.1 million for the three year fiscal period, 2011 through 2013. Because this legislation allows an acceleration of depreciation, the long-term impact of this legislation is zero because only the timing of the depreciation expense is modified. Revenue gains begin to materialize beginning in FY 2013.

Corporation Income Tax (Group 1)

Figure 8 shows more detailed corporation income tax collection data (less refunds) for the first eight months of FY 2011 compared to the same period of FY 2010. Other years are shown for reference. As shown in the figure, total corporation income tax collections less refunds are 24.9 percent (\$13.3 million) above last year. This growth rate is well above the assumed growth rate in HJ2.

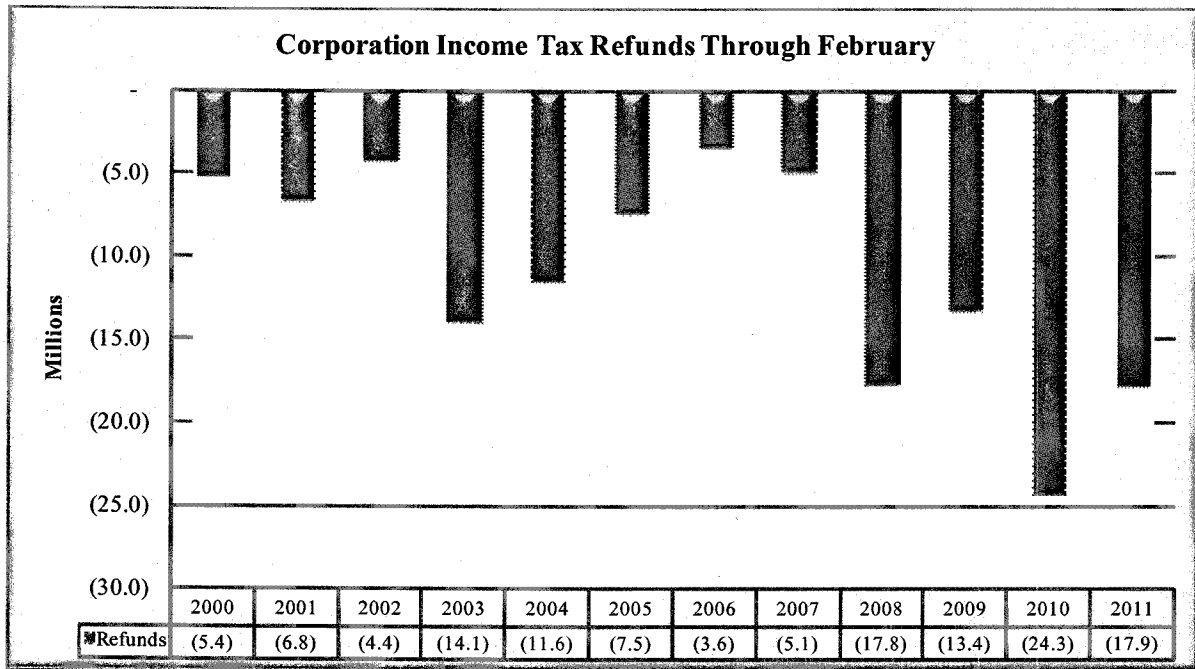
Figure 8



This amount suggests that corporation income tax collections are improving and that economic conditions must be recovering from the “Great Recession”. However, an analysis of historical collection trends shows that FY 2010 collection patterns were abnormal. Part of last year’s fluctuations can be explained by the high level of refunds issued. Figure 9 shows the refund activity through February of the respective fiscal years. As the figure shows, refunds through February of last year were considerably higher than previous years. If an extrapolation of current corporation tax collections (including refunds) is compared to other fiscal years, then year to date collections are on target with the estimates contained in HJ2. A comparison to FY 2010 collections produces an inappropriate conclusion.

H.R. 4853 allows corporate taxpayers to expense depreciable assets placed in service between September 9, 2010 and the end of 2011 and also allows a 50% bonus depreciation for depreciable assets placed in service in 2012. As estimated by the DOR, the expected revenue reduction from this federal legislation is \$16.4 million for the three year fiscal period, 2011 through 2013. Because this legislation allows an acceleration of depreciation, the long-term impact of this legislation is zero because only the timing of the depreciation expense is modified. Revenue gains begin to materialize beginning in FY 2013.

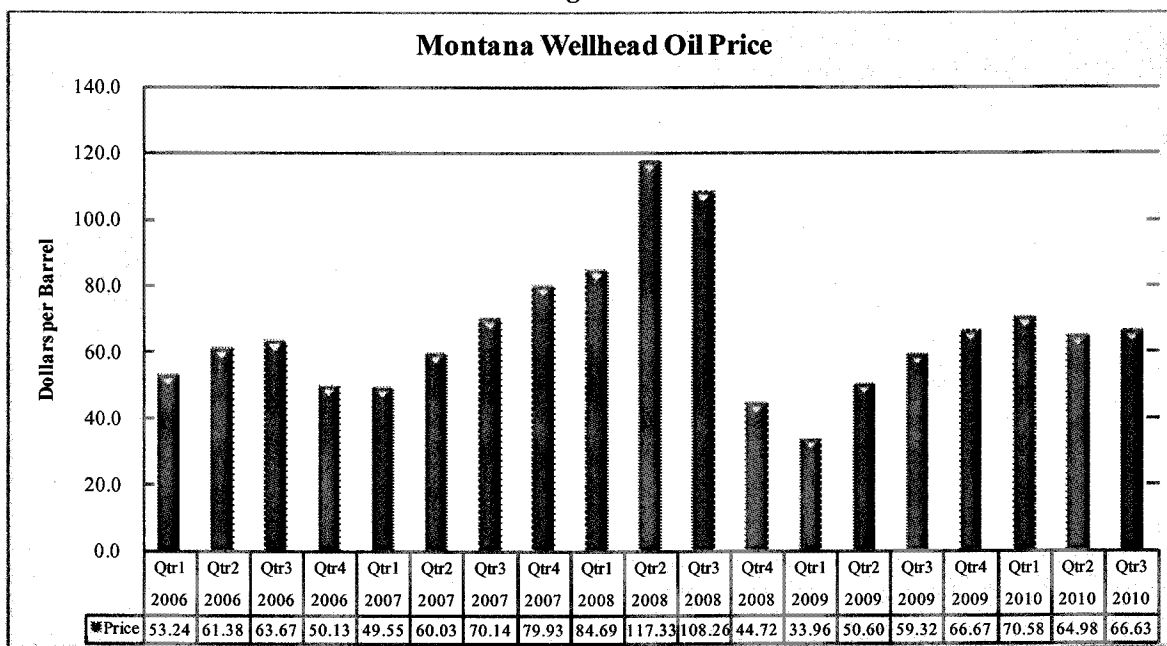
Figure 9



Oil and Gas Production Tax (Group 1)

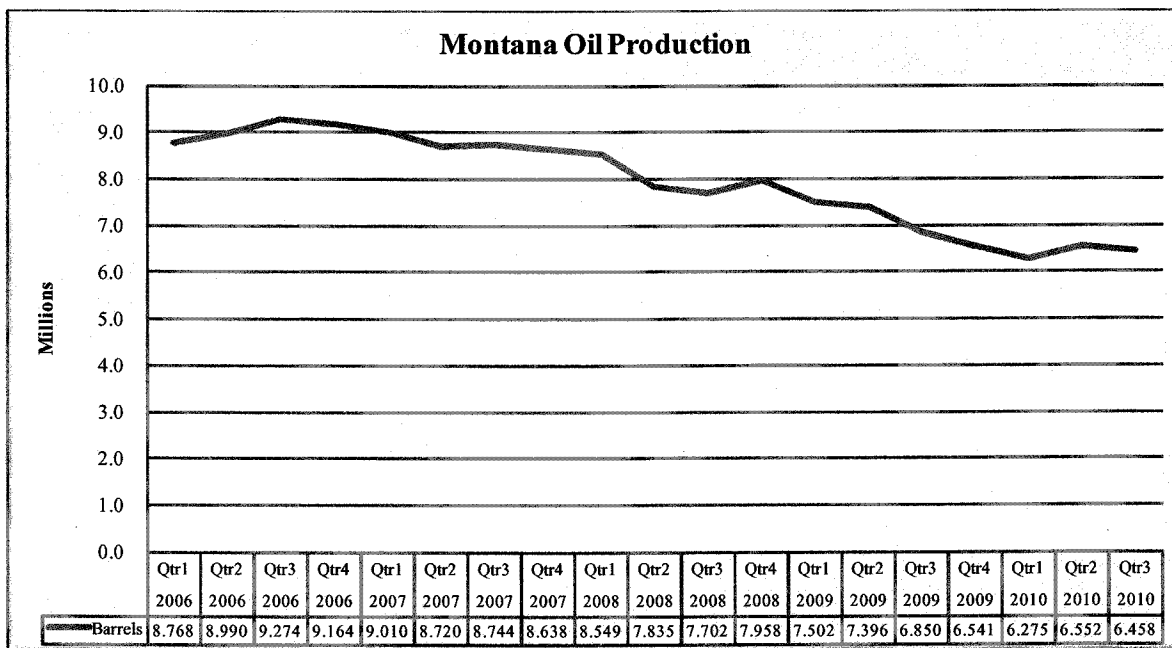
Total oil and gas production tax collections are \$1.7 million (8.2 percent) above last year as of the end of February. These collections represent economic conditions through the 3rd quarter of calendar 2010 as compared to the 3rd quarter of calendar 2009. This increase was not unexpected since Montana oil prices averaged \$66.63 per barrel for the 3rd quarter of calendar 2010 versus \$59.32 per barrel for the 3rd quarter of calendar 2009. Fourth quarter calendar 2010 collections are expected to increase as Montana oil prices are expected to average close to \$75 per barrel during the quarter, well above the \$66.67 per barrel average during the 4th quarter of calendar 2009. The next payment of oil and gas production taxes will be processed by late April.

Figure 10



Although the average wellhead price continues to be at high levels, total production in Montana continues to decline as shown in Figure 11. Production is expected to be about 25.7 million barrels for calendar 2010.

Figure 11



There appears to be some stability in production emerging during the last three quarters of calendar 2010. Further data will be necessary to identify whether a new production pattern is occurring.

Video Gaming Tax (Group 1)

After two quarters of video gaming tax collections, revenues are \$3.0 million below last year for the same period. The estimates contained in HJ2 assumed that revenues from this source would show signs of recovery beginning in FY 2011. At this time, a recovery has not materialized and the second quarter collections are similar to FY 2003 amounts. The revised LFD recommendations for the three year period are \$19.9 million less than the HJ2 estimates.

Metalliferous Mines Tax (Group 1)

The metalliferous mines tax is based on the production of metal commodities and the price received for those commodities. Commodity prices continue to be extremely strong and are higher than the assumptions contained in HJ2. The revised LFD recommendations for the three year period are \$7.7 million greater than the HJ2 estimates.

The following section of the report addresses those sources shown in Group 2 of Figure 5. All of these sources except for property tax and the "All Other Categories" are showing collections patterns that are exceeding the HJ2 revenue estimate. Most of these increases are not due to changes in economic conditions but are merely caused by computer system issues, accounting changes, or timing patterns between fiscal years. The one exception to this generalization is lodging facilities taxes.

Vehicle Fees/Taxes (Group 2)

The Department of Justice implemented the MERLIN system to process vehicle fees/taxes. During FY 2010, the system continued to have production issues that were eventually resolved by the end of the fiscal year. Because of these problems and the impact it had on collection trends, a comparison between fiscal years would be erroneous. This means the \$5.6 million increase shown between fiscal years is not due to improved economic conditions but merely reflects the accounting problems that were evident in FY 2010.

Property Tax (Group 2)

Property tax revenues are up slightly in FY 2011 when compared to the same period for FY 2010. This increase amounts to \$3.5 million but is slightly below the HJ2 expected rate. The revenue estimates adopted by RTIC in November were based on certified taxable values from DOR for FY 2011. Since this is the value the 95 mills is assessed against, the timing of taxpayer payments between November and May is probably the reason for the small variation in these revenue collections.

Liquor Excise Tax (Group 2)

The liquor excise tax is the 16 percent tax assessed on the value of liquor sold in Montana. Two years ago, the Legislative Auditor recommended the DOR change their accounting procedures regarding deposits from this tax. This change was implemented in FY 2010 which had the effect of temporarily understating current year collections in FY 2010. Because this accounting change resulted in an understatement of collections in FY 2010, a comparison to this year is inappropriate.

Lodging Facilities Sales Tax (Group 2)

The lodging facilities sales tax is due the last day of the month following the end of the calendar year. Historically, these payments are deposited in January and February with the largest portion being deposited in February. This fiscal year, the larger portion was recorded in January instead of February. Since this timing issue is now resolved, collections appear to be exceeding HJ2 estimates. A revised recommendation (\$1.1 million for three years) for this source has been incorporated in the total revision amounts.

Electrical Energy Tax (Group 2)

The electrical energy tax is due 30 days after the end of the quarter. In previous years, these deposits have shown up in January and February. This fiscal year, the deposit was all made in the month of January. Since this timing issue is now resolved, collections appear to be exceeding the HJ2 growth rate. However, collection patterns were abnormal during FY 2010 which distorts the comparison to the previous fiscal year. A comparison to other fiscal years shows that collections are consistent with the HJ2 estimate.

Retail Telecommunications Tax (Group 2)

The retail telecommunications tax is due 60 days after the end of the quarter. In previous years, these deposits spanned across February and March. This fiscal year, deposits were made in January and February with additional receipts expected in March. Because of this timing issue, collections appear to be exceeding HJ2 estimates. Collections by the end of December were on track with the HJ2 estimate.

Other Revenue (Group 2)

For revenue estimation purposes, there is a revenue source called "All Other Revenue". This particular source is the summation of numerous smaller sources that are estimated separately and combined together for presentation purposes. This source is above last year by \$2.6 million but this increase is due to unexpected deposits from the Natural Resource Damage program (\$1.3 million) and acceleration in abandoned property collections (\$0.9 million). These two components account for \$2.2 million of the \$2.6 million improvement. Revenue from both of these sources is one-time-only.

All Other Categories (Group 2)

All of the remaining revenue sources not mentioned above was combined together. Collectively, the total for all these sources are slightly above the anticipated amount contained in HJ2. A detailed analysis of all sources in this group was not prepared. However, some of the large components were analyzed and adjustments were made accordingly.

SUMMARY OF LFD ANALYSIS

Based on our analysis of the new data received from all the sources mentioned previously, the information indicates that total general fund revenue estimates could be understated by \$19.5 million in FY 2011 and \$44.0 million in the 2013 biennium as compared to the revenue estimates contained in HJ2. A majority of these amounts is due to changes in the underlying assumptions for individual income tax refunds, federal legislation impacts, and commodity prices for oil, natural gas, and metals.

Other adjustments are recommended for several other sources because of the interrelationship with the various economic assumptions provided by IHS. In total these changes are small and do not change the revenue outlook significantly.

The total recommended adjustments in general fund revenue estimates are shown in Figure 12. The estimates as adopted by RTIC on November 19, 2010 (HJ2) and the LFD recommendations developed in March are shown. The change amount is calculated by comparing the HJ2 estimate with the March LFD analysis. A positive number means the LFD new estimate is above the amount contained in HJ2.

Figure 12

Recommended Adjustments to HJ2 Figures in Millions				
Revenue Category	Revision FY 2011	Revision FY 2012	Revision FY 2013	Biennium 2012-13
Individual Income Tax	23.635	27.545	33.880	61.425
Corporation Income Tax	(5.960)	(8.229)	(0.204)	(8.433)
Oil & Gas Production Tax	3.092	1.192	(2.582)	(1.389)
Metalliferous Mines Tax	2.450	2.600	2.620	5.220
Video Gaming Tax	(6.007)	(6.286)	(7.223)	(13.509)
All Other Categories	<u>2.283</u>	<u>1.016</u>	<u>(0.320)</u>	<u>0.696</u>
Total General Fund	\$19.494	\$17.838	\$26.171	\$44.009
Interest & Income	\$9.300	\$0.000	\$0.000	\$0.000

The legislature is faced with an extremely difficult task of developing a 2013 biennium budget in light of current economic conditions and how these conditions will affect future revenue collections. The duration and intensity of the "Great Recession" was not anticipated and had a profound impact on state general fund revenues. Even with these revised upward recommendations, it will take several years before revenues return to the peak level observed in FY 2008. As the new data were reviewed and analyzed by staff, two key points were noted.

First, with receipt of year to date collections and revised economic data, anticipated revenues are performing as expected except for the significant change in refunds issued, federal legislation, and oil, natural gas, and metal commodity prices. Without these adjustments, revenue collections would be close to being on target with the HJ2 estimates. Computer system issues,

accounting changes, and collection timing patterns explain why other sources are showing improvement over FY 2010 collections and do not reflect changing economic conditions.

Second, the immediate task for the legislature is to adopt a balanced 2013 biennium budget. The major issue the legislature must face is the risk associated with the revised LFD recommendations.

There is a distinct possibility that refunds issued may be higher than anticipated when the peak refund season occurs in April and May. However, there is also the possibility that refunds will subside and that less refunds will be issued between now and June 30. Refunds issued from January 1 to March 16 are up 2.5 percent from last year.

As the economy recovers, there is a good chance that individual and corporate taxpayers may adjust their estimated payments upward to reflect the improvement in their non-wage income levels. This adjustment could show up in estimated payments received in April and June. However, if taxpayers do not adjust their estimated payments (no penalty assessed), there is a high probability that refunds issued a year from now will be reduced reflecting the higher incomes for tax year 2011. Currently, there is no evidence that non-wage income will be up significantly.

Regardless, there are risks – risks that could impact the revenue estimates negatively or positively. The LFD recommends the legislature discuss and debate revenue estimates to ensure the best possible numbers are used to balance the 2013 biennium budget.

WHAT TO WATCH FOR NEXT MONTH

This section of the report highlights the new data available between now and mid-April. This data should help staff and the legislature assess any new trends that may be developing that affect general fund revenue estimates.

Data to be Received

Early April	IHS Global Insight, National economic forecast
	IHS Global Insight, State economic forecast
	Written report and data tables
	SABHRS month-end data
	General fund revenue monitoring report – revenue collections through March
	DOR selected tax return data
	Oil and gas tax returns
	Coal severance tax returns
	Individual and corporate tax refunds